FENWICK & WEST

Silicon Valley Venture Capital Survey Third Quarter 2017

Full Analysis

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Cynthia Clarfield Hess, Mark Leahy and Khang Tran

Background

We analyzed the terms of 183 venture financings closed in the third quarter of 2017 by companies headquartered in Silicon Valley.

Overview of Fenwick & West Results

Valuation results increased substantially in Q3 2017, which followed two quarters of modest increases. Overall, valuation metrics are well above their historical average, although still off from the highs recorded in mid-2015.

- Up rounds exceeded down rounds 79% to 10%, with 11% flat. This was an increase from Q2 2017 when up rounds exceeded down rounds 77% to 13%, with 10% flat. This was the highest percentage of up rounds and the lowest percentage of down rounds since Q1 2016.

- The Fenwick & West Venture Capital Barometer™ showed an average price increase in Q3 2017 of 80%, an increase from 64% recorded in Q2 and the highest average price increase recorded since Q3 2015. Series B, C and D rounds all recorded stronger valuation results compared to the prior quarter while the average price increase for Series E+ rounds declined considerably from 55% in Q2 to 19% in Q3.

- The median price increase of financings in Q3 2017 was 46%, an increase from 30% in Q2 and the highest median price increase since Q3 2015.

- In contrast to the prior quarter when its valuation metrics lagged those of the other industries, the life sciences industry recorded the strongest valuation results in Q3 2017. The hardware and software industries also recorded strong valuation metrics in Q3, although the valuation results for the software industry were modestly weaker than the elevated results recorded by the industry in the prior quarter. The internet/digital media industry recorded a lower average price increase compared to the prior quarter; however, the median price increase was significantly higher.

Overview of Other Industry Data

The U.S. venture environment continued to improve marginally in the third quarter of 2017, though still well below peak levels of mid-2015, while the exit environment remained challenging.

- Although the pace of investments declined, the amount of capital invested was flat from Q2 to Q3 of 2017.
- Later stage investment allocation continued to rise in Q3 2017 while seed/angel investment allocation rebounded from the lows recorded in Q2.
- What many expected at the beginning of 2017 to be a strong year for initial public offerings has not come to pass with the pace of IPOs only marginally increasing from the depressed level of 2016.
- The number of acquisitions of U.S. venture-backed companies in 2017 and the value of these deals continued to decline in Q3 from Q2.
- Venture capital fundraising during the first three quarters of 2017 is off pace from elevated 2016 levels, but the number of first-time funds closed is on pace for the highest annual amount raised in the past decade.

Venture Capital Investment

U.S. venture capital investment deal flow in Q3 2017 declined compared to the prior quarter and the year ago period and remained significantly below the peak levels of 2015. Despite the decline in deal count, the total dollar value of financings in Q3 2017 was relatively flat compared to Q2 2017 and significantly higher compared to Q3 2016.

A summary of results published by three leading providers of venture data is below:

Comparison between Q3 and Q2 2017:

	Q3 2017 ($Billions)	Q2 2017 ($Billions)	Difference %	Q3 2017 Deals	Q2 2017 Deals	Difference %
VentureSource[1]	$18.7	$17.6	6%	1,043	1,113	-6%
PitchBook-NVCA[2]	$21.5	$22.9	-6%	1,706	2,164	-21%
MoneyTree[3]	$19.0	$18.9	1%	1,207	1,208	0%
Average	$19.7	$19.8	0%	1,319	1,495	-12%

Comparison between Q3 2017 and Q3 2016:

	Q3 2017 ($Billions)	Q3 2016 ($Billions)	Difference %	Q3 2017 Deals	Q3 2016 Deals	Difference %
VentureSource[1]	$18.7	$14.1	33%	1,043	1,046	0%
PitchBook-NVCA[2]	$21.5	$15.3	40%	1,706	2,071	-18%
MoneyTree[3]	$19.0	$14.4	32%	1,207	1,286	-6%
Average	$19.7	$14.6	35%	1,319	1,468	-10%

[1] Dow Jones VentureSource (“VentureSource”)

[2] PitchBook-NVCA Venture Monitor (“PitchBook-NVCA”)

[3] PwC/CB Insights MoneyTree™ Report (“MoneyTree”)

One of the prevailing trends in venture capital in recent years has been the concentration of investment dollars into a fewer number of companies, especially later stage companies, and this trend was evident again in Q3 2017. Average round size was boosted by a number of large financing rounds in Q3, including billion dollar raises by WeWork and Fanatics. According to MoneyTree, there were 26 financings that raised $100 million or more in Q3, down from the 33 financings that raised $100 million or more in Q2, but still well above the depressed activity seen in 2016. In addition, five new VC-backed companies reached unicorn status (a valuation of at least $1 billion) in Q3, down significantly from the 10 new unicorn companies in Q2, but an increase from the unicorn creation rates recorded in 2016.

According to VentureSource, the median amount invested per financing round by venture capitalists or venture capital-type investors (i.e., those making equity investments in early-stage companies from a fund with multiple limited partners) was unchanged from the prior quarter at $7.0 million, which was the highest median investment amount since Q2 2008. Seed, first and second rounds all recorded moderately higher median investment amounts in Q3 2017 compared to the prior quarter while the median investment amount for later stage rounds declined from $20.0 million in Q2 2017, which was a two-year high, to $18.3 million in Q3.

According to Moneytree, seed/angel investment deal allocation increased to 27% in Q3 2017 from a two-year low of 22% in Q2, although seed/angel investment amount allocation was unchanged at 3%. Meanwhile, early stage (Series A) investment deal and amount allocations declined to 24% and 12%, respectively, in Q3 from 28% and 15%, respectively, in Q2. Expansion stage (Series B) and later stage (Series D and E+) investment deal allocations were relatively unchanged from the prior quarter; however, expansion stage investment amount allocation declined moderately to 32% in Q3 from 34% in Q2 and later stage investment amount allocation increased to 42% in Q3 from 39% in Q2.

Investments into information technology declined in Q3 2017, comprising 20% of the invested capital and 31% of the total number of deals in Q3, according to VentureSource, down from 28% and 34%, respectively, in Q2. Although the deal allocation for consumer services companies was up marginally from 18% in Q2 to 19% in Q3, the percentage of the invested capital for these companies declined from 24% in Q2 to 16% in Q3. Business and financial services allocation, on the other hand, increased from 24% of both the invested capital and the total number of deals in Q2 to 40% and 25%, respectively, in Q3. MoneyTree similarly reported a dip in investments into internet and mobile and telecommunications from 49% and 13%, respectively, of the invested capital in Q2 to 41% and 9%, respectively, of the invested capital in Q3, while investments into business products and services increased from 1% of the invested capital in Q2 to 13% of the invested capital in Q3.

Regionally, Northern California continues to take in the largest share of investments at 35% of the invested capital and 32% of the total number of deals in Q3, according to VentureSource, followed by the Mid-Atlantic region at 32% of the invested capital and 24% of the total number of deals and the Southern California region at 10% of the invested capital and 10% of the total number of deals.

The San Francisco Bay Area recorded the largest decline in investment dollars from $8.1 million in Q2 to $6.5 million in Q3, while the New York metro area recorded the greatest gain from $2.3 million in Q2 to $5.4 million in Q3.

IPO Activity

The market for initial public offerings continued to be depressed. There were seven U.S. venture-backed IPOs in Q3 2017, according to VentureSource, a decline from 18 U.S. venture-backed IPOs in Q2 and 13 U.S. venture-backed IPOs in Q3 2016. The amount raised in the IPOs declined from $1.8 billion in Q2 2017 to $609 million in Q3, which was the lowest amount since Q1 2016. Initial public offerings of information technology companies in 2017 had been on pace to exceed the number of IPOs of IT companies in each of the past two years; however, no IT company had an IPO in Q3. Meanwhile, although five of the seven IPOs in Q3 were by healthcare companies, the number of IPOs by healthcare companies is on track to be the lowest since 2012.

Partly as a result of later stage companies being able to raise significant capital from private markets, companies are taking longer to go public and are doing so at higher valuations. According to VentureSource, although the median time from the initial equity funding to an IPO decreased moderately from 7.96 years in Q2 2017 to 7.61 years in Q3, it still reflected a general upward trend in the IPO timeline observed since 2013. The median amount raised prior to IPO increased from $105.9 million in Q2 2017 to $120.1 million in Q3, which was the highest median amount since Q4 2014. In addition, the medium pre-IPO valuation in Q3 was $312.4 million, a decline from $335.8 million in Q2, but considerably higher than the medium pre-IPO valuations recorded in the last few years.

Merger and Acquisition Activity

U.S. M&A deal volume decreased in Q3 2017, with VentureSource reporting a decline in the number of acquisitions of U.S. venture-backed companies from 153 in Q2 2017 and 156 in Q3 2016 to 129 in Q3 2017, which was the lowest number of acquisitions since Q2 2015. The overall value of these deals also declined considerably from $17.2 billion in Q2 2017 and $26.4 billion in Q3 2016 to $11.4 billion in Q3 2017, which was also the lowest aggregate deal value since Q2 2015. The number and value of acquisitions of information technology companies increased from 38 and $4.2 billion, respectively, in Q2 2017 to 52 and $4.8 billion, respectively, in Q3, but reflect a decline from the year ago period when there were 62 acquisitions of IT companies at an aggregate value of $5.9 billion. The number and value of acquisitions of healthcare companies decreased from 25 and $2.5 billion, respectively, in Q2 2017 and 25 and $3.3 billion, respectively, in Q3 2016 to 15 and $1.7 billion, respectively, in Q3 2017.

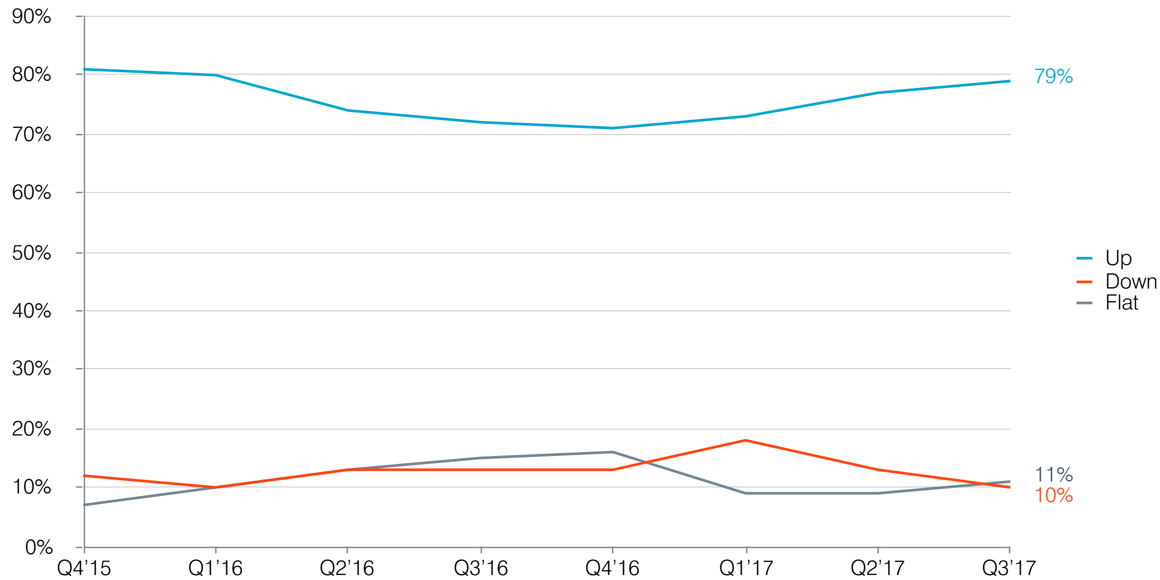
In contrast to the trend of companies delaying an IPO exit, younger companies are being acquired at lower valuations in 2017 in comparison to 2016. According to VentureSource, the median time from the initial equity funding to an acquisition of 4.9 years in Q3 2017 was flat compared to Q2 2017, but down from 5.3 years in Q3 2016. In addition, the median amount raised prior to an acquisition decreased from $12.1 million in Q2 2017 and $13.3 million in Q3 2016 to $10.3 million in Q3 2017, which reflects a downward trend observed since 2014. Meanwhile, partly due to the absence of any billion dollar acquisitions in the quarter, the average deal value declined from $112.4 million in Q2 2017 and $169.1 million in Q3 2016 to $88.2 million in Q3 2017.

Venture Capital Fundraising

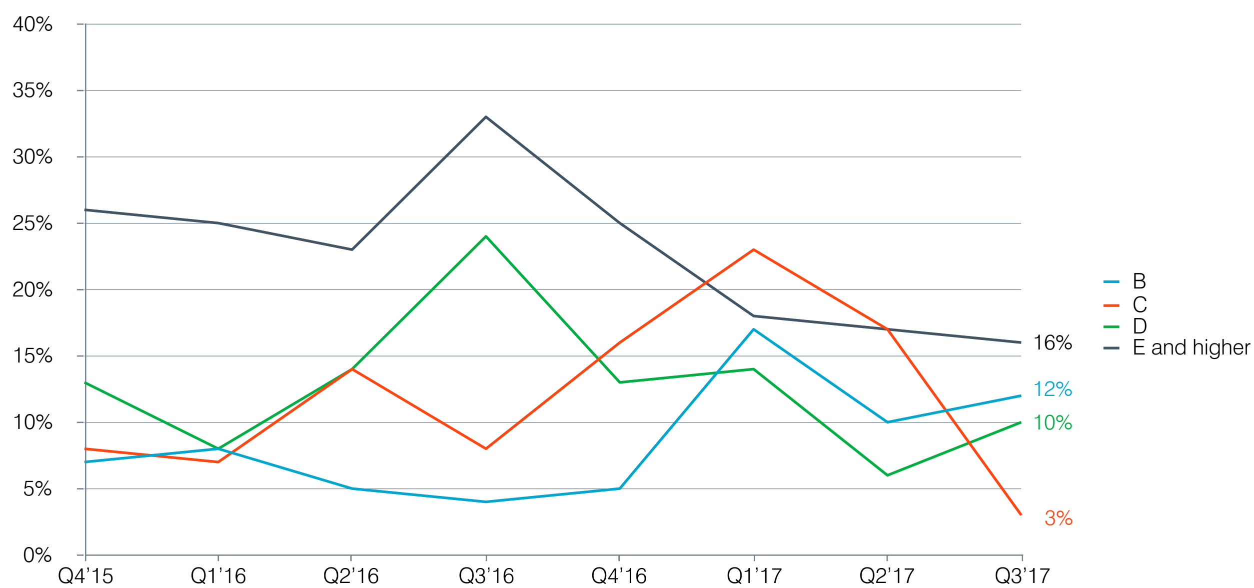
According to PitchBook-NVCA, venture capitalist firms have raised $24.4 billion through the first three quarters of 2017, including $5.3 billion across 116 funds in Q3 2017. VC fundraising continues to be strong in 2017 despite being off pace from elevated 2016 levels. First-time funds, in particular, continued to record strong fundraising numbers, with $2.4 billion raised across 25 first-time funds through the first three quarters of 2017, on pace for the highest annual amount raised in the past decade. Only two mega-funds (fund size of more than $1 billion), including a $1.5 billion fund closed by IVP in Q3, and eight other funds valued at more than $500 million have closed during the first three quarters of 2017 after a number of prominent VCs raised large funds in 2016. At the other end of the spectrum, the number of microfunds (fund size of less than $50 million) that have closed to date in 2017 have also declined.

Fenwick & West Data on Valuation

PRICE CHANGE—The direction of price changes for companies receiving financing in a quarter, compared to their prior round of financing.

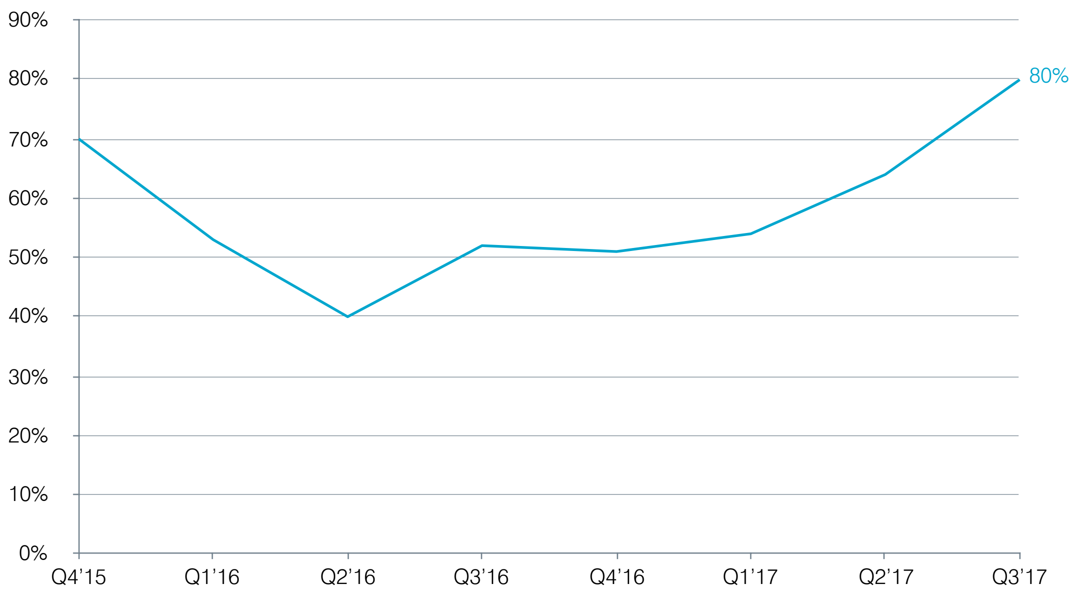


The percentage of **DOWN ROUNDS** by series were as follows:

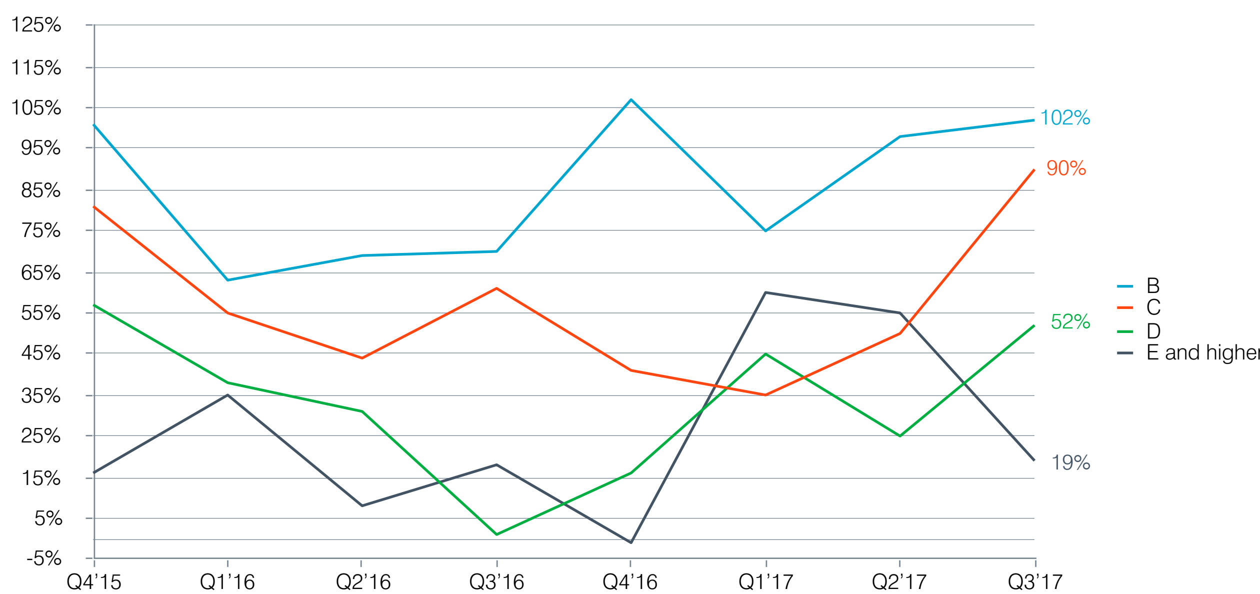


EXPANDED PRICE CHANGE GRAPH—Set forth below is the direction of price changes for each quarter since 2004.

THE FENWICK & WEST VENTURE CAPITAL BAROMETER™ (magnitude of price change)—Set forth below is the <u>average</u> percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the average, all rounds (up, down and flat) are included, and results are not weighted for the amount raised in a financing.

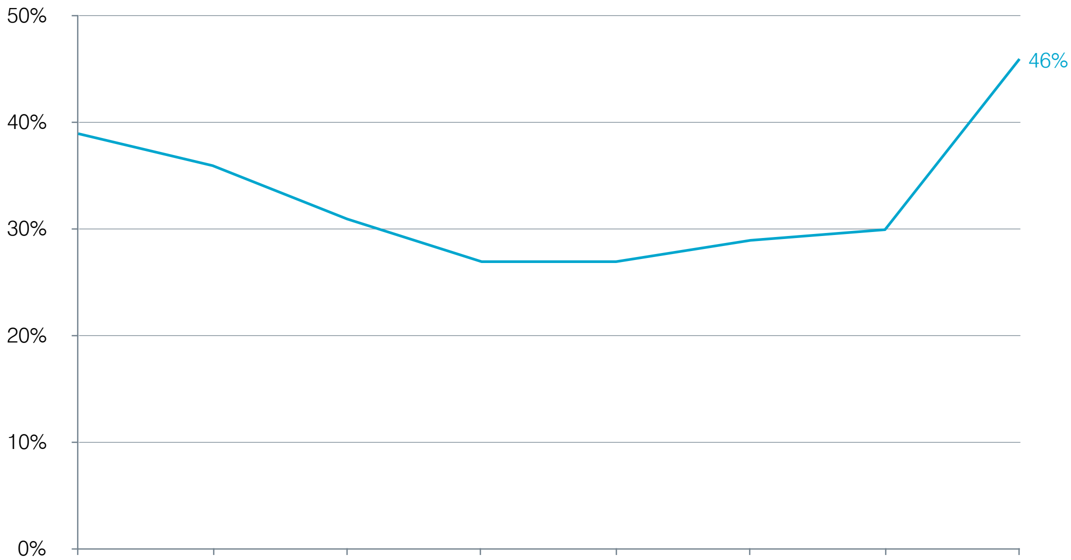


The Barometer results by series are as follows:

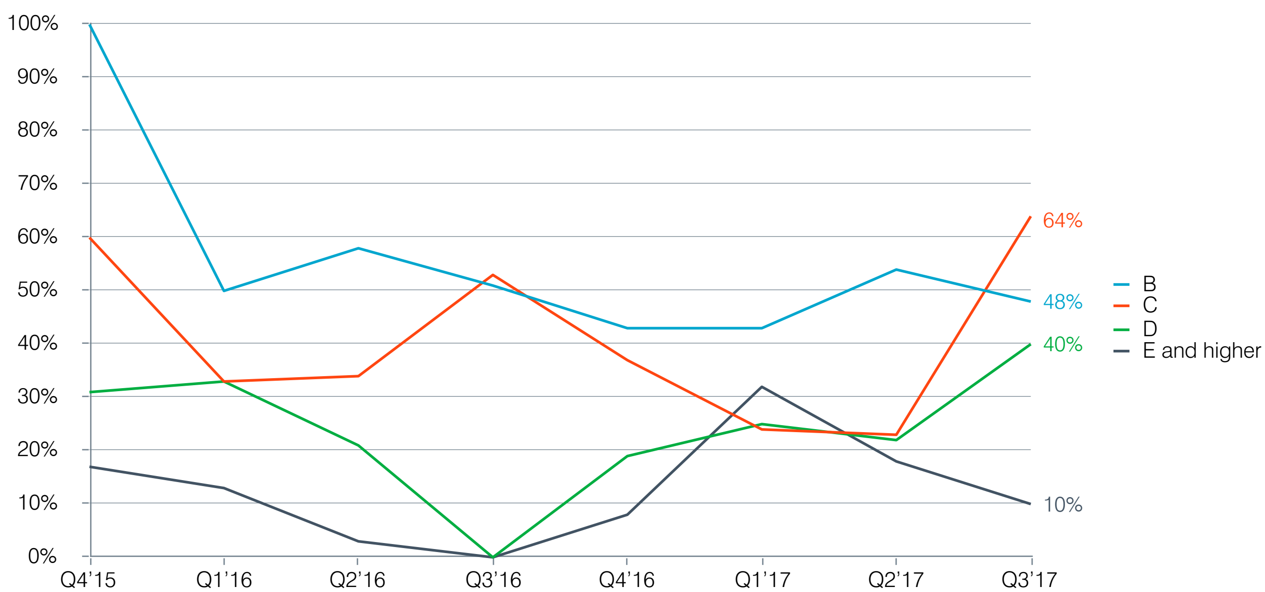


EXPANDED BAROMETER GRAPH—Set forth below is the average percentage price change for each quarter since we began calculating this metric in 2004.

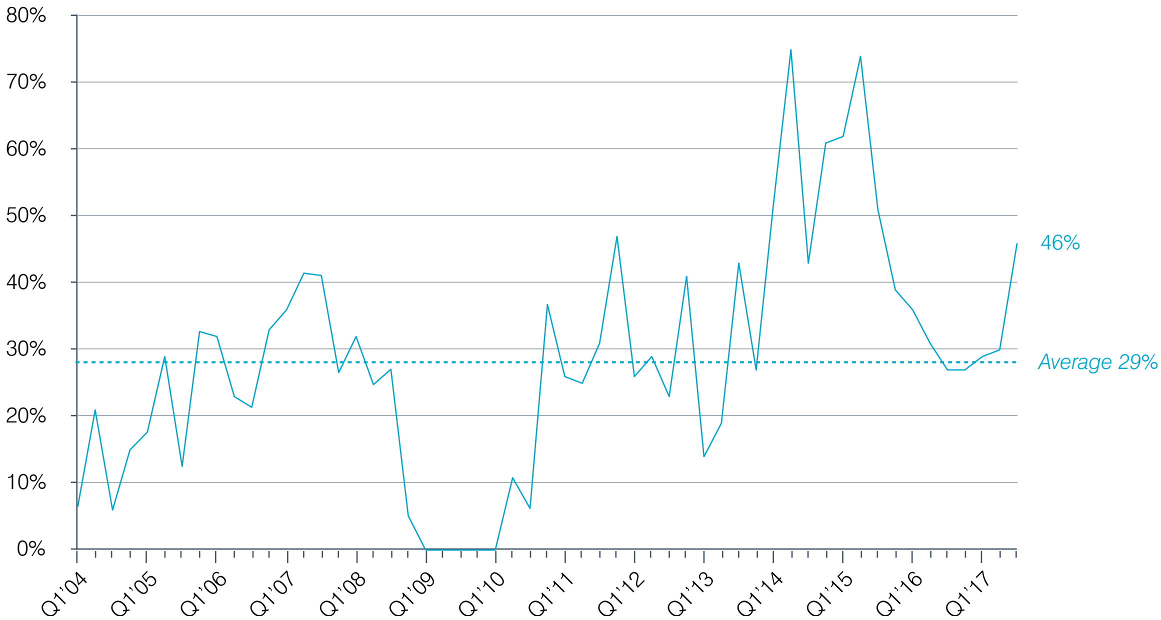
MEDIAN PERCENTAGE PRICE CHANGE—Set forth below is the median percentage change between the price per share at which companies raised funds in a quarter, compared to the price per share at which such companies raised funds in their prior round of financing. In calculating the median, all rounds (up, down and flat) are included, and results are not weighted for the amount raised in the financing. Please note that this is different than the Barometer, which is based on average percentage price change.



MEDIAN PERCENTAGE PRICE CHANGE BY SERIES.



EXPANDED MEDIAN PRICE CHANGE GRAPH—Set forth below is the median percentage price change for each quarter since we began calculating this metric in 2004.



RESULTS BY INDUSTRY FOR DIRECTION OF PRICE CHANGES AND AVERAGE AND MEDIAN PRICE CHANGES — The table below sets forth the direction of price changes, and average and median price change results for companies receiving financing in this quarter, compared to their previous round, by industry group. Companies receiving Series A financings are excluded as they have no previous rounds to compare.

Industry	Up Rounds	Down Rounds	Flat Rounds	Average Price Change	Median Price Change	Number of Financings
Software	82%	10%	8%	82%	47%	61
Hardware	69%	8%	23%	82%	56%	13
Life Science	83%	9%	9%	89%	34%	23
Internet/Digital Media	83%	8%	8%	49%	47%	24
Other	62%	15%	23%	107%	18%	13
Total all Industries	**79%**	**10%**	**11%**	**80%**	**46%**	**134**

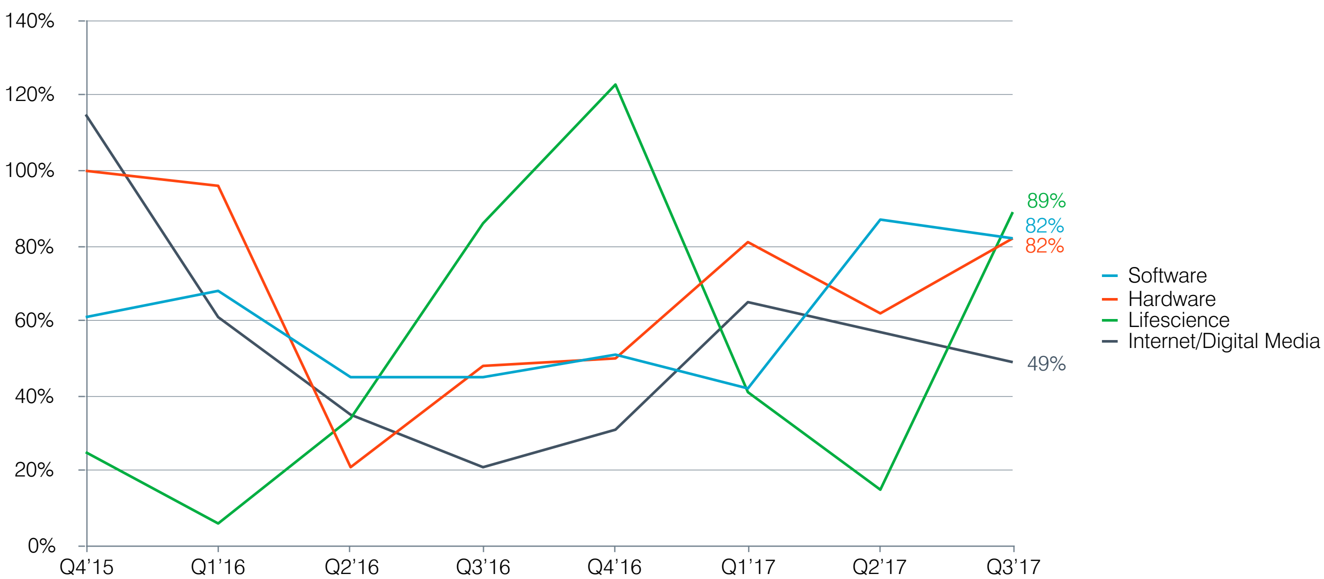
DOWN ROUND RESULTS BY INDUSTRY — The table below sets forth the percentage of "down rounds," by industry groups, for each of the past eight quarters.

Down Rounds	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17
Software	10%	6%	14%	15%	10%	20%	14%	10%
Hardware	18%	20%	16%	8%	18%	18%	17%	8%
Life Science	25%	19%	13%	18%	13%	17%	16%	9%
Internet/Digital Media	6%	10%	13%	14%	16%	24%	11%	8%
Other	11%	0%	8%	0%	17%	0%	8%	15%
Total all Industries	**12%**	**10%**	**13%**	**13%**	**13%**	**18%**	**13%**	**10%**

BAROMETER RESULTS BY INDUSTRY—The table below sets forth Barometer results by industry group for each of the last eight quarters.

Barometer	Q4’15	Q1’16	Q2’16	Q3’16	Q4’16	Q1’17	Q2’17	Q3’17
Software	61%	68%	45%	45%	51%	42%	87%	82%
Hardware	100%	96%	21%	48%	50%	81%	62%	82%
Life Science	25%	6%	34%	86%	123%	41%	15%	89%
Internet/Digital Media	115%	61%	35%	21%	31%	65%	57%	49%
Other	33%	19%	56%	78%	-5%	69%	43%	107%
Total all Industries	**69%**	**55%**	**39%**	**54%**	**54%**	**54%**	**64%**	**80%**

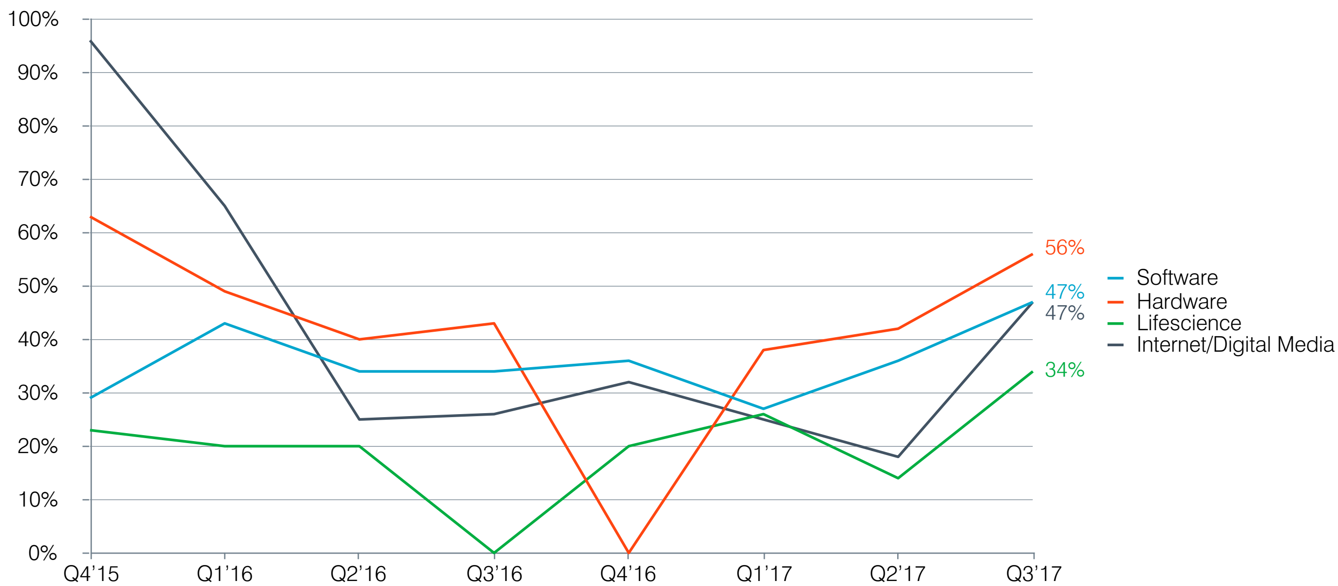
A graphical representation of the above is below.



MEDIAN PERCENTAGE PRICE CHANGE RESULTS BY INDUSTRY —The table below sets forth the median percentage price change results by industry group for each of the last eight quarters. Please note that this is different than the Barometer, which is based on average percentage price change.

Median % Price Change	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17
Software	29%	43%	34%	34%	36%	27%	36%	47%
Hardware	63%	49%	40%	43%	0%	38%	42%	56%
Life Science	23%	20%	20%	0%	20%	26%	14%	34%
Internet/Digital Media	96%	65%	25%	26%	32%	25%	18%	47%
Other	38%	9%	39%	53%	0%	59%	44%	18%
Total all Industries	**39%**	**37%**	**31%**	**28%**	**28%**	**29%**	**30%**	**46%**

A graphical representation of the above is below.

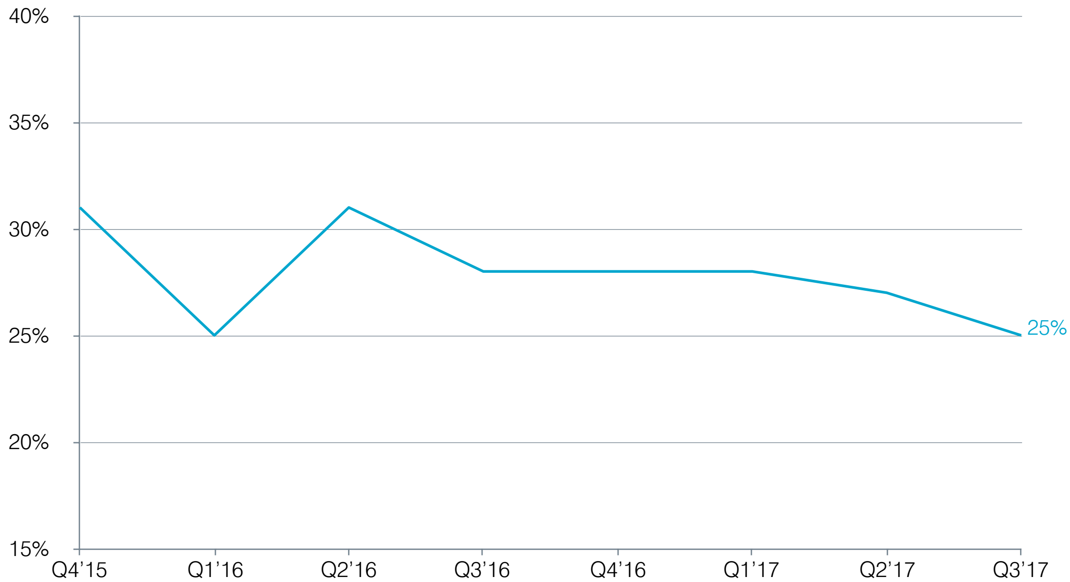


FINANCING ROUND—This quarter's financings broke down by series according to the chart below.

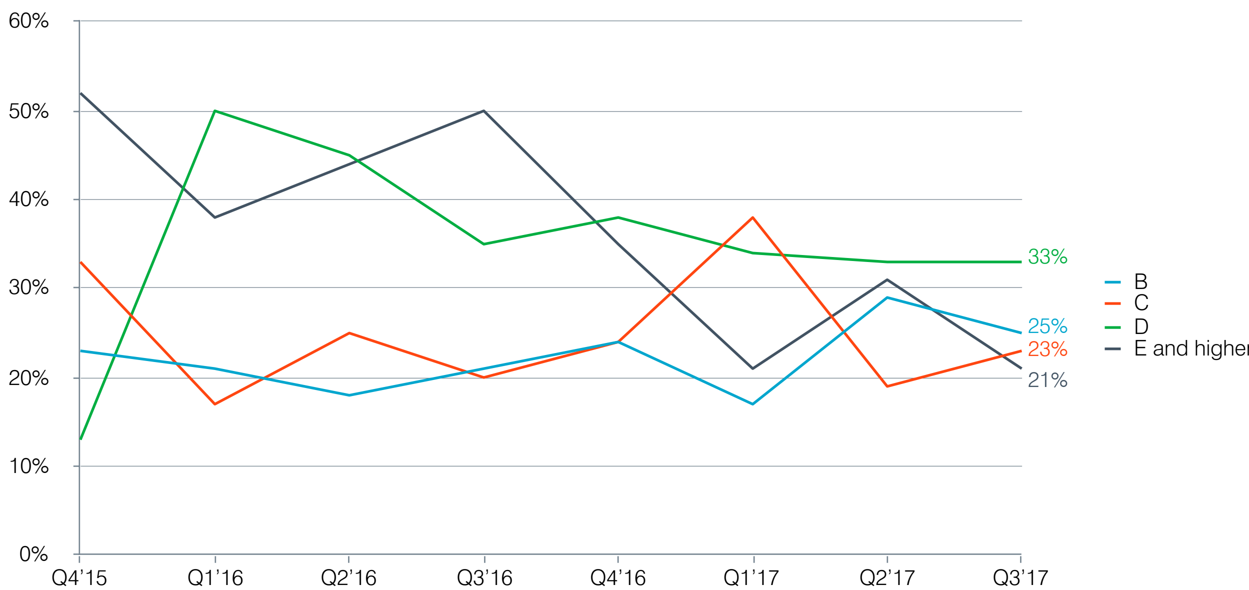
Series	Q4'15	Q1'16	Q2'16	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17
Series A	27%	23%	20%	24%	21%	29%	28%	27%
Series B	21%	28%	24%	33%	30%	18%	23%	32%
Series C	25%	29%	24%	18%	20%	20%	23%	19%
Series D	11%	9%	12%	12%	13%	15%	9%	11%
Series E and Higher	16%	11%	21%	13%	16%	17%	17%	10%

Fenwick & West Data on Legal Terms

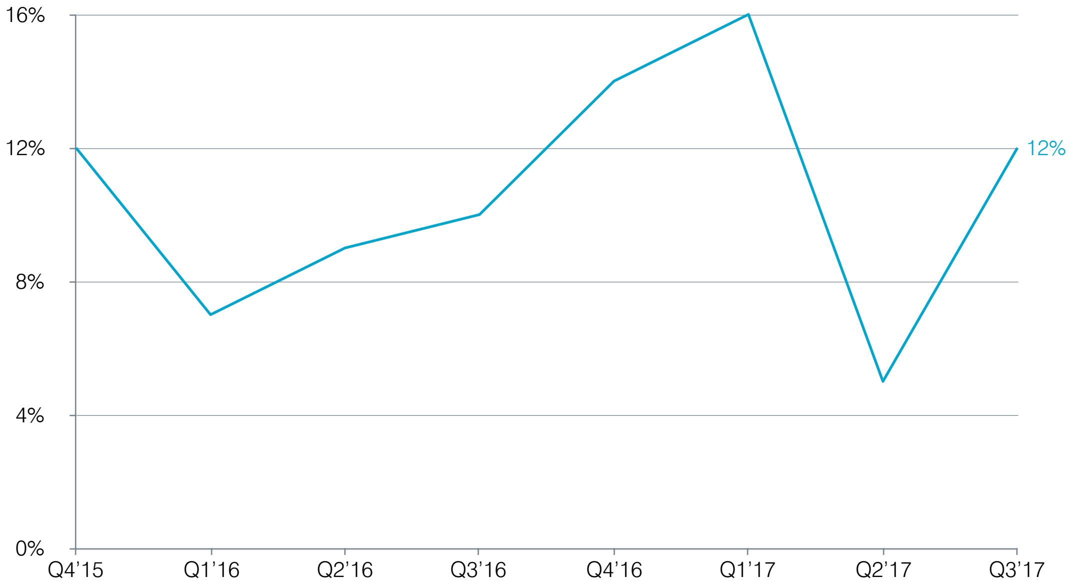
LIQUIDATION PREFERENCE—Senior liquidation preferences were used in the following percentages of financings.



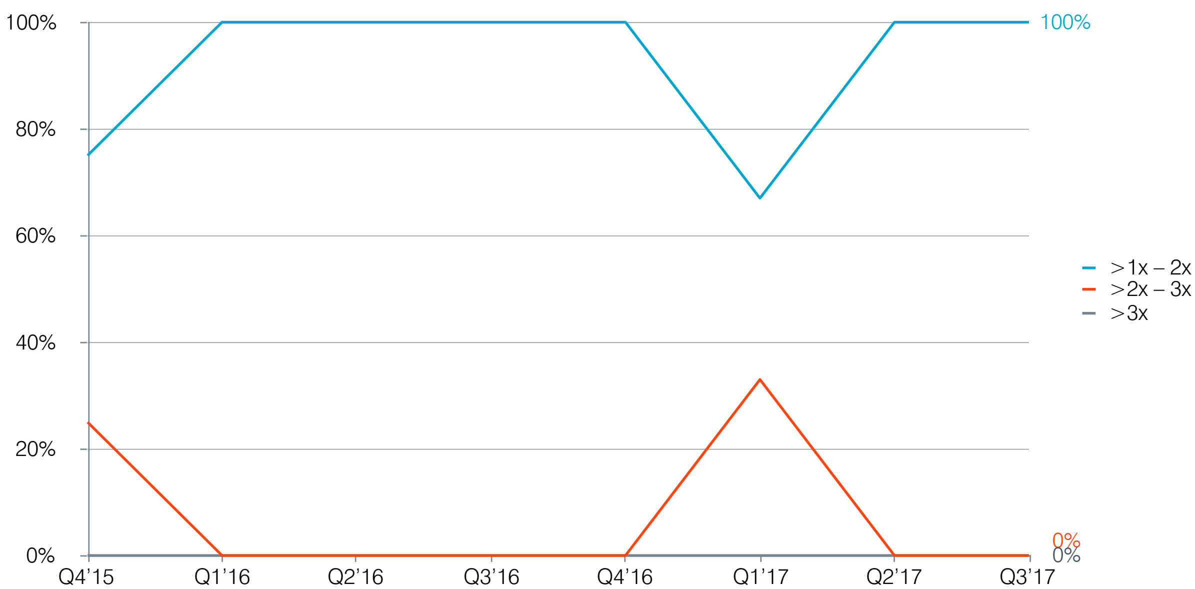
The percentage of senior liquidation preference by series was as follows:



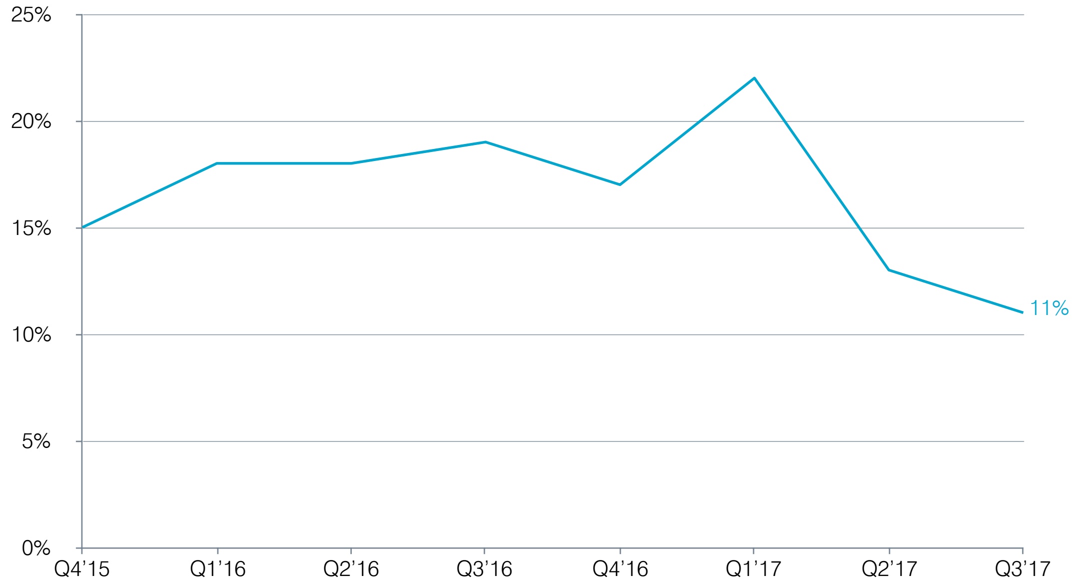
MULTIPLE LIQUIDATION PREFERENCES — The percentage of senior liquidation preferences that were multiple liquidation preferences were as follows:



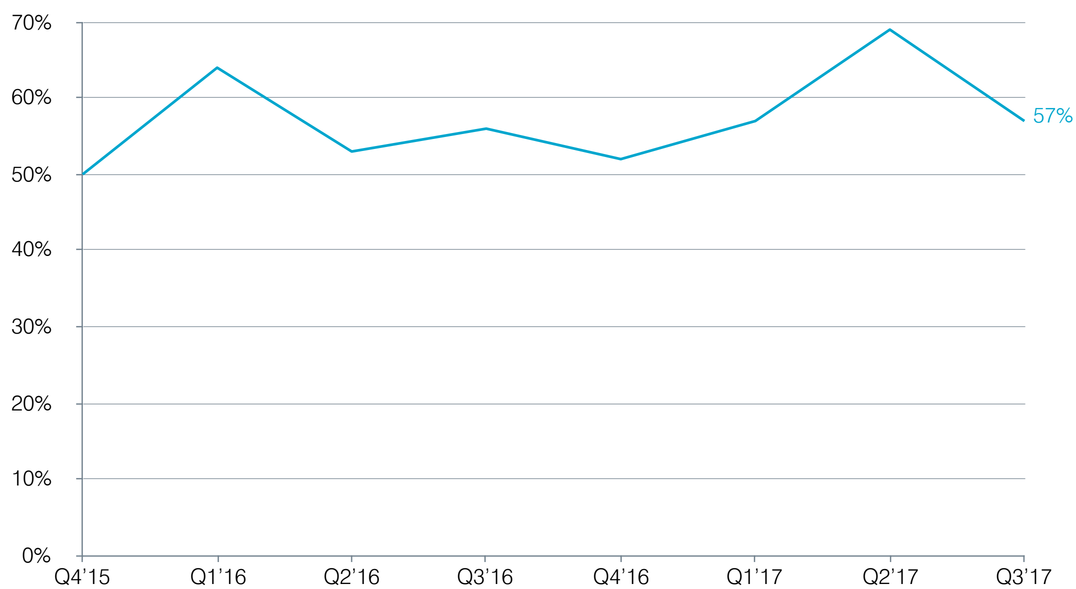
Of the senior liquidation preferences that were a multiple preference, the ranges of the multiples broke down as follows:



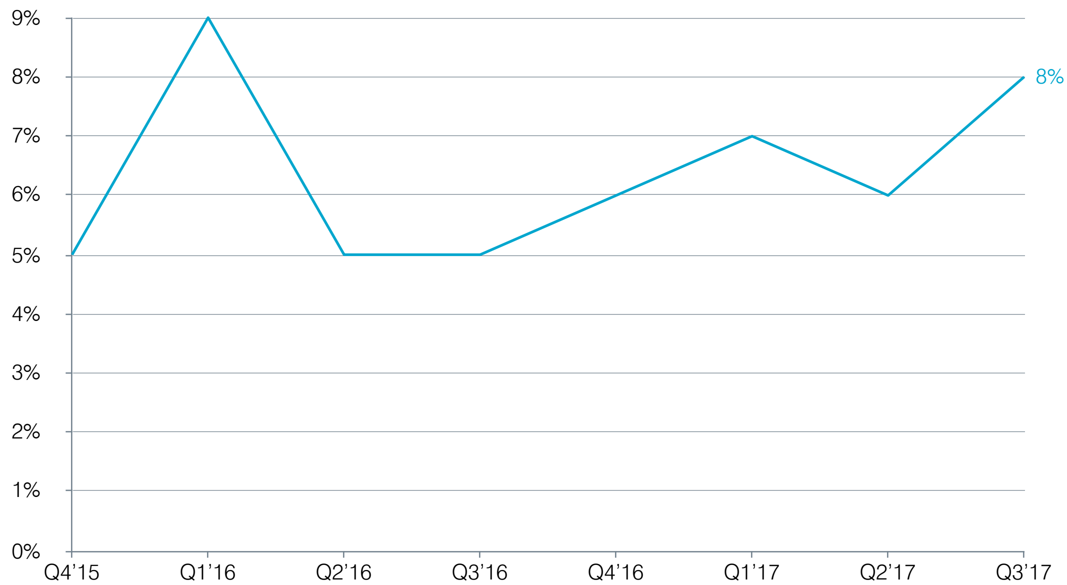
PARTICIPATION IN LIQUIDATION —The percentages of financings that provided for participation were as follows:



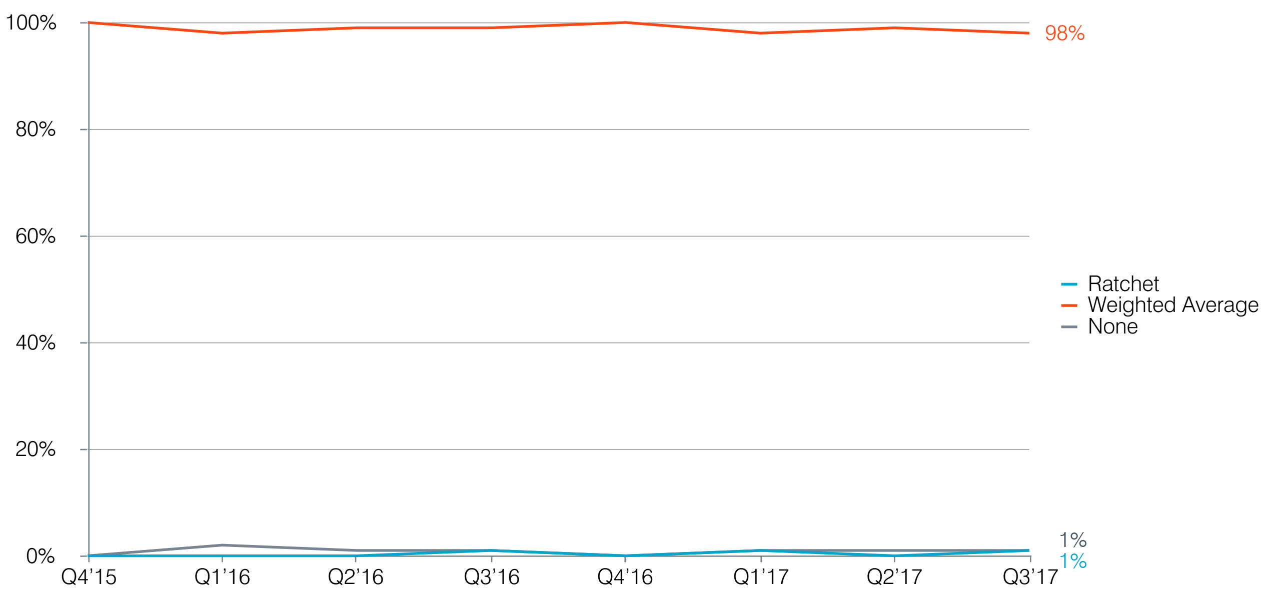
Of the financings that had participation, the percentages that were not capped were as follows:



CUMULATIVE DIVIDENDS – Cumulative dividends were provided for in the following percentages of financings:

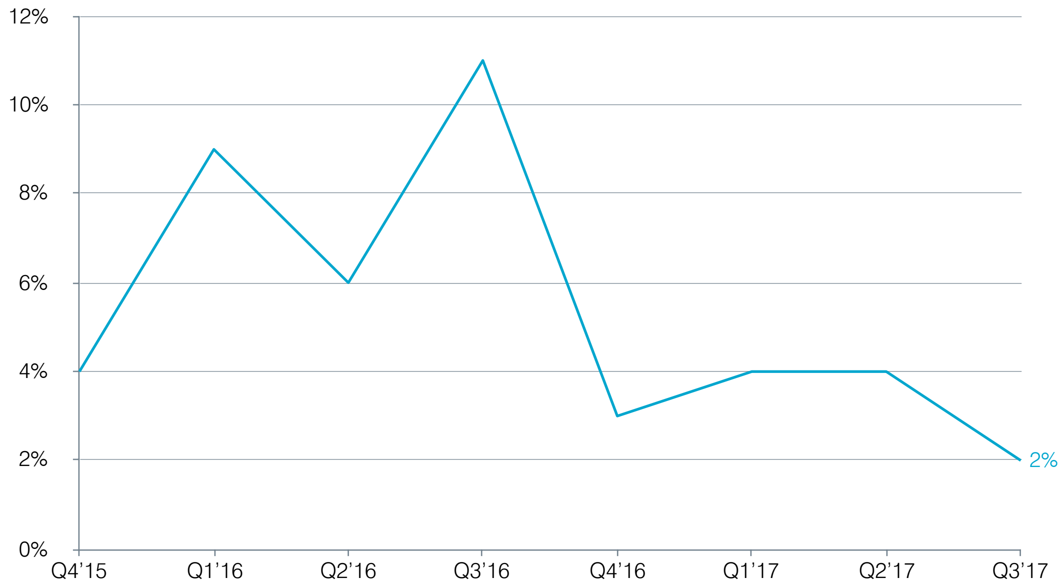


ANTIDILUTION PROVISIONS –The uses of (non-IPO) antidilution provisions in the financings were as follows:

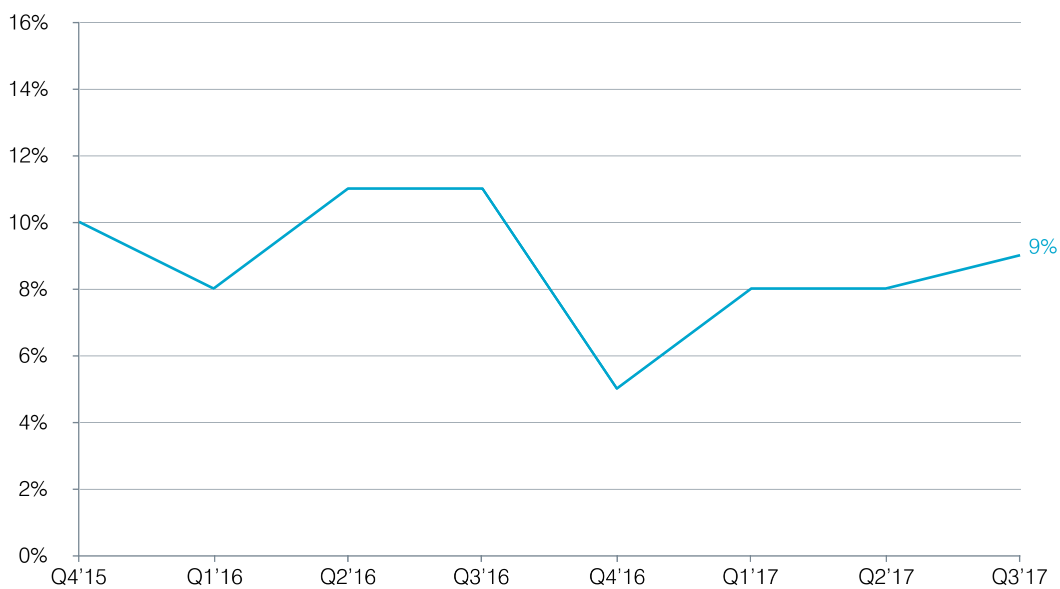


Please note that the chart above only applies to non-IPO anti-dilution provisions. In other words, the chart refers to anti-dilution provisions that protect the investor against a future venture financing at a price below what the investor paid. The chart does not include anti-dilution provisions designed to protect against an IPO at a price below the price paid by the venture investor (e.g., an IPO ratchet), because those provisions are generally only negotiated/included in very late stage, high value deals. We believe it would not be useful to provide a percentage of all financings that have IPO anti-dilution provisions, because it will provide a result that is artificially low. An analysis of IPO anti-dilution provisions is included in our Unicorn Survey, which by its nature is focused on late stage, high value deals.

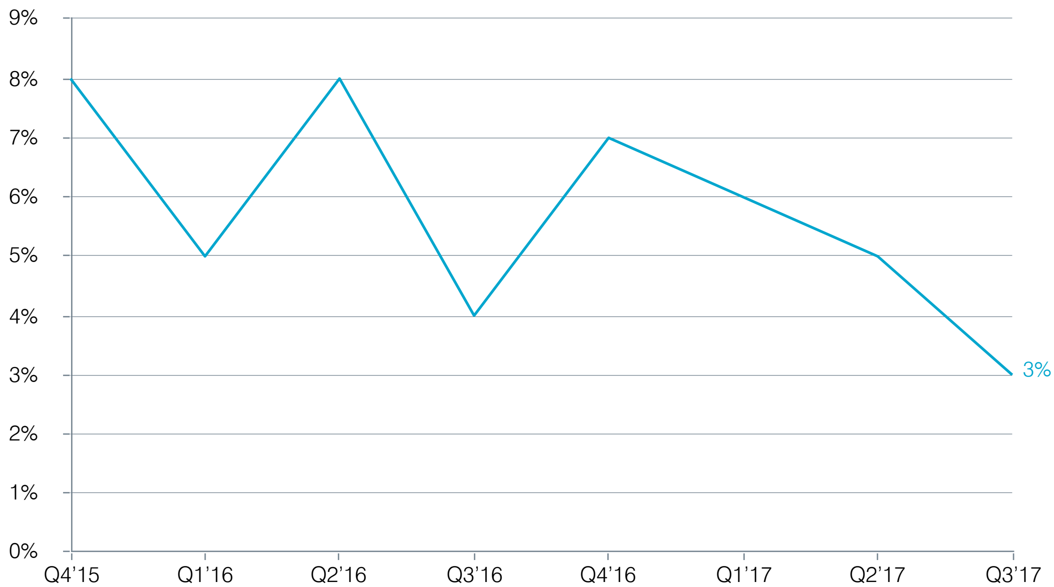
PAY-TO-PLAY PROVISIONS – The percentages of financings having pay-to-play provisions were as follows:



REDEMPTION – The percentages of financings providing for mandatory redemption or redemption at the option of the investor were as follows:



CORPORATE REORGANIZATIONS – The percentages of post-Series A financings involving a corporate reorganization (i.e. reverse splits or conversion of shares into another series or classes of shares) were as follows:



About our Survey

The Fenwick & West Venture Capital Survey was first published in the first quarter of 2002 and has been published every quarter since then. Its goal is to provide information to the global entrepreneurial and venture community on the terms of venture financings in Silicon Valley.

The survey is available to all, without charge, by signing up at www.fenwick.com/vcsurvey/sign-up. We are pleased to be a source of information to entrepreneurs, investors, educators, students, journalists and government officials.

Our analysis of Silicon Valley financings is based on independent data collection performed by our lawyers and paralegals, and is not skewed towards or overly representative of financings in which our firm is involved. We believe that this approach, compared to only reporting on deals handled by a specific firm, provides a more statistically valid and larger dataset.

For purposes of determining whether a company is based in "Silicon Valley" we use the area code of the corporate headquarters. The area codes included are 650, 408, 415, 510, 925, 916, 707, 831 and 209.

Note on Methodology

When interpreting the Barometer results please bear in mind that the results reflect the average price increase of companies raising money in a given quarter compared to their prior round of financing, which was on average about 18 months prior. By definition the Barometer does not include companies that do not do follow-on financings (which may be because they went out of business, were acquired or went public). Accordingly we believe that our results are most valuable for identifying trends in the venture environment, as opposed to calculating absolute venture returns. Please also note that our calculations are not "dollar weighted," i.e. all venture rounds are treated equally, regardless of size.

About the Authors

Cynthia Clarfield Hess is Co-Chair of Fenwick's Startup and Venture Capital Group. In her 25 plus years as a corporate attorney, Cindy has counseled technology companies on a broad range of corporate transactional matters, from formation matters and venture capital financings to mergers and acquisitions and public offerings, representing both companies and underwriters. She has worked with a wide range of high-technology clients – from established technology stalwarts to emerging companies developing disruptive technologies, which include some of the hottest and most innovative companies in the mobile, SaaS and social media spaces.

Mark Leahy, Co-Chair of Fenwick's Startup and Venture Capital Group and a seasoned advisor to technology companies on a broad range of corporate transactional matters, focuses on providing legal solutions that advance his clients' business objectives. His practice focuses on venture capital financings, corporate governance, mergers and acquisitions, and public offerings. His expertise spans a wide range of technologies, including software, semiconductor, internet/e-commerce, and data management and storage.

Khang Tran supports the firm's knowledge management efforts by collecting and sharing knowledge and expertise across the firm, which in turn, is leveraged to improve the quality of legal services to the firm's clients.

Contact/Sign Up Information

For additional information about this report please contact Cynthia Hess at 650.335.7238; chess@fenwick.com or Mark Leahy at 650.335.7682; mleahy@fenwick.com at Fenwick & West.

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